Chapter 7: Local Government Funding Mechanisms in Other States

Local governments rely on a variety of funding sources to provide programs for their citizens. Fees for service, locally imposed taxes, and grants from state and federal agencies provide revenues to fund local government programs. Cities, counties and special purpose districts depend upon state legislatures to provide, by statute, fee assessment and taxing authority sufficient to fund these programs and services. In cases where local tax bases are not strong enough to provide local revenues such as cities with few retail sales and a local sales tax, states may provide supplemental funds through programs that share state tax revenues. In Minnesota revenues from locally imposed taxes may be shared among a group of regional governments to "equalize" the tax revenues among the "have" and the "have not" jurisdictions.

During the 19th Century counties and cities relied mostly on property taxes to fund their programs. Beginning late in the 19th Century and continuing through the first half of the 20th Century, cities and some counties in the United States began imposing taxes on business revenues. These local taxes, many of which continue to the present, have taken several forms. Some are franchise fees on businesses paid annually and scaled to the bracket in which a business' gross or net income falls. Others are direct taxes paid monthly or quarterly and imposed as a percentage of gross or net business income. Beginning during the great depression of the 1930's and continuing to the present day, states have granted local governments authority to impose sales taxes.

State laws determine the degree to which local governments may tax, and the objects and transactions subject to local government taxes. Each state's local government tax structure differs from all others even though there are some similarities. This is the result of states trying to address the rising needs for local revenues to fund growing expectations for local government programs while at the same time trying to deal political realities.

There are a few references to local government revenue sharing in the literature. However, local governments sharing revenue is still uncommon.

There are a couple of themes that emerge from a review of available literature on city and county taxes. These observations are summarized in the following sections. This information is taken from a review of Commerce Clearing House digests of state tax programs, the results of extensive Internet searches for on-point literature, and a review of other textual materials available to the Department of Revenue.

PROPERTY TAXES

The following states, by statute, do not impose a state property tax but devote property taxes to county, city, or special purpose districts (including school districts). Exceptions to this general observation are noted and marked with an asterisk *.

Alaska*	Cities and other districts impose tax on realty. State may impose tax on oil and gas production properties.
Arizona	
Arkansas	
Idaho	Property taxes make up 29% of all tax revenues
Kentucky	Cities, fire districts, and hospital districts can impose property taxes. Counties cannot impose property taxes
Louisiana	
Mississippi	
New Jersey*	State imposes property tax on railroads and communications

	companies only
New Mexico	
New York	Local governments impose property tax. State law provides separate property tax authority for New York City.
North Carolina	
Ohio	
Oregon*	Most but not all property tax revenues go to local governments
Pennsylvania	
Rhode Island*	City and county governments impose property taxes; by law state takes a share of locally imposed property tax revenues to fund general state government.
South Carolina	
Tennessee	
Texas	
Vermont	

Note: The National Association of Counties says that the property tax is the largest single source of county revenues in the United States.

LOCAL SALES (AND USE) TAXES

Thirty-five of the 50 states provide cities and or counties and other special districts the authority to levy retail sales (and use) taxes. The states that do not allow local governments to levy sales and use taxes are:

Connecticut	Maine	New Jersey
Hawaii	Maryland	Rhode Island
Indiana	Massachusetts	West Virginia
Kentucky	Michigan	

In addition Delaware, Montana, New Hampshire, and Oregon have neither a state nor a local retail sales tax.

For those states that impose a sales tax and permit cities, counties, and special districts to impose a sales tax, of the aggregate or total combined state and local tax rate, on the average the state tax alone accounts for 60% to 70% of the combined rate while the local tax accounts for 30% to 40% of the combined rate.

In all but six states the state sales tax rate is higher than the highest possible local sales tax rate. Local rates may vary from area to area depending upon the rate structure and the possible "layering" of a special district rate on top of a city rate on top of a county rate.

Those states with higher possible local rates are:

Table 7.1 States with Highest Possible Local Sales and Use Tax Rates		
State	Local Rate	State Rate
Alabama	7.0%	4.0%
Colorado	7.0%	2.9%
Louisiana	6.25%	4.0%
Oklahoma	6.0%	4.5%
Missouri	4.5%	4.225%
New York**	4.5%	4.25%

**State and local tax rates based on 2004 reports.

Alaska allows cities or boroughs to levy a retail sales tax of up to 7%. The State of Alaska does not levy sales and use taxes.

Local Liquor Taxes

Most states reserve liquor taxes for state government revenue sources. These are direct taxes on liquor not additional special sales taxes on beer, wine or spirits.

Six states allow all or selected local governments to levy local liquor (volume) taxes on beer, wine or spirits:

Georgia - beer, wine, and spirits
Alabama - beer
Illinois (Chicago only) - beer and wine
Louisiana - beer
Maryland - beer
New York (New York City only) - beer

Local Motor Vehicle Fuel Taxes

Some states permit local governments to impose a local motor vehicle fuel (gallonage) tax in addition to the state imposed fuel taxes.

Alabama	cities only
District of Columbia	imposes a local fuel tax by permission of Congress
Florida	counties only
Hawaii	cities and counties, local rates may be higher than state rate.
Montana	counties only
Oregon	selected cities and counties (administered locally)
South Dakota	cities only
Tennessee	cities and counties
Virginia	Special transportation districts

Note: Washington permits cities, counties and special purpose transportation districts to impose a local motor vehicle fuel tax to be administered by the Department of Revenue, but none impose the tax.

Local Real Estate Transfer Taxes

Washington permits cities and counties to impose local real estate excise taxes. A number of other states permit a variety of taxes on the transfer of real estate. Those states that allow local taxes on real estate transfers in a similar fashion to Washington are:

California	cities and counties
Delaware	cities and counties
Florida	counties
Illinois	Cook County and Chicago only
Maryland	cities, counties, and special districts
Michigan	counties
Nevada	counties
New York	counties
Ohio	counties
Pennsylvania	counties
Virginia	cities and counties
Wyoming	counties

Other states impose deed transfer fees, recording fees, or other taxes not based on the value of the property sold or transferred from one independent party to another independent party.

Local Utility Taxes

Washington allows cities to impose taxes on utilities such as electrical power, water, sewerage, and gas services. Other states allow local governments to impose utility taxes similar to Washington. Some allow cities or counties to impose gross receipt taxes, licensing fees, and in some cases taxes on net receipts.

The states allowing local utility taxes are:

Arkansas	cities and counties but only for economic development
California	counties but only in unincorporated areas
Florida	cities but only on communications services
Illinois	cities; Chicago can charge higher rates than any other city.
Michigan	cities
Minnesota	cities
Nevada	counties on water services only
Oregon	cities
Virginia	cities and counties
West Virginia	cities

Local Revenue Sharing

Revenue sharing among local jurisdictions is rare. In the past Washington considered local cooperation and revenue diversion or sharing as a way of consolidating local government services under one jurisdiction's management but paying for the service by having all local governments receiving the service pay part of their revenues to the service providing city or county. In the early 1990's the legislature enacted laws making this scheme possible, but to date no local governments have used this plan.

There are, however, several cases where local government revenue sharing is working. Minnesota has provided laws allowing regions comprised of various cities and counties to "equalize" property tax revenues. Jurisdictions with a highly productive property tax base set aside part of their property tax revenues that are then distributed by formula among those jurisdictions in the region that do not have private properties that produce enough revenues to provide local government programs and services.

In 1998 California enacted a constitutional amendment allowing cities and counties to enter into local sales tax revenue sharing agreements. The purpose of the program is to offset the problems that occur when annexation of retail areas deprive a county of part of its sales tax base. One limited report of the use of this scheme in Modesto in Stanislaus County stated that revenue sharing has changed how annexation and land use decisions are made with regard to the city's boundary lands and county lands adjacent to the city.

In the spring of 2005, the City of Cleveland, Ohio and Richfield Village and Richfield Township agreed to share tax revenues within a newly created economic development district. One entity agreed to provide water services to the district, another agreed to extend sewers to the district and collect taxes, and the third agreed to provide land and general government services to the area. All agreed to share in the new revenues.

In those areas where revenue sharing has been successfully implemented, it appears to be working well. There is no analysis readily available to explain why it has not been adopted by other jurisdictions.

State Revenue Sharing with Local Governments

Revenue sharing between states and their respective local governments is much more common than general revenue sharing between local governments. The following table describes the revenue sharing structures of several states whose revenue sharing patterns differ from Washington’s.

Table 7.2

Revenue Sharing in Other States

State	Annual Revenue Shared	Jurisdictions Receiving Funds and Purpose(s)	Distribution Formula or Method	State Agency Administering Program
Louisiana	$90,000,000	Parishes (counties) to offset effect of property tax homestead exemption.	80% on population of parish, 20% on number of homestead exemptions in parish.	State treasury, although state revenue agency actively participates.
New York	$396,000,000 down from a high of $539,000,000 in 1989, and low of $266,000,000 in 1994. Note: 83% goes to New York City.	Cities, towns, and villages. Unrestricted use of funds. County program started in 2000 and ended in 2004.	Three different programs based on size of cities and purposes of program. Formulas based on population and on need basis determined by criteria.	State Comptroller.
Minnesota	Varies from year to year, from a low of $200 million to a high of $350 million	Cities, school districts and some special purpose districts.	Portions of property tax revenues go into regional property tax sharing pools with those jurisdictions with lower total property valuations receiving a greater share of revenues than those with higher valuations. Formula is based on population and each jurisdictions per capita commercial property tax base value as compared to the per capita region based average.	Distribution formula set by state legislature. State Department of Revenue provides data for formula. Unclear who is responsible for administering distributions of revenue.

Table 7.2

Revenue Sharing in Other States - Continued

State	Annual Revenue Shared	Jurisdictions Receiving Funds and Purpose(s)	Distribution Formula or Method	State Agency Administering Program
Tennessee	$741,000,000 in 2001; more recent figures not reported.	Counties and cities.	Of the $741 million distributed, $276 million was earmarked for specific local government programs; the use of the balance, $465 million, was unrestricted. The moneys are derived from 12 different state imposed taxes and federal payments in lieu of property taxes (TVA). Each of the tax revenues is distributed using a separate formula. The formula factors vary but may include population and land area of jurisdiction, equal shares, and location of the incidence of tax.	State Treasury and state Department of Revenue.
Maine	$113,500,000 in 2005	Municipalities (493 - including two Indian Tribal Reservations).	Distribution formula is based on each city's population multiplied by the city's total property tax assessment and then divided by the state valuation of property in the city. The source of funds distributed is the state's general-purpose fund.	State Treasurer's Office and the Maine Municipal Association (an association of the cities receiving the shared revenues).

Table 7.2

Revenue Sharing in Other States - Continued

State	Annual Revenue Shared	Jurisdictions Receiving Funds and Purpose(s)	Distribution Formula or Method	State Agency Administering Program
Michigan	$1.1 billion (about $439 million less than amount distributed in 2001).	Cities and counties. Purposes are to equalize funds among jurisdictions according to their needs and to supplement some jurisdictions' abilities to raise revenues.	In past state income tax revenues were redistributed to counties and cities in accordance with each jurisdiction's "relative tax effort" a comparison of property, income and excise taxes to the state average for all jurisdictions. Recently, amounts of shared funds were frozen and source of revenues shared changed to the state sales tax. The focus of revenue sharing is changing from urban to suburban and rural areas. The old distribution formula has been replaced with three new formulas:1. Jurisdiction population weighted by relative service delivery burden. 2. Taxable value of property per capita (attempts to provide more funds for jurisdictions with lower property value per capita), and 3. A yield equalization formula that provides a minimum amount per jurisdiction.	State Department of Management and Budget. The state Office of Revenue and Tax Analysis (Michigan Department of Treasury) provides distribution formula data.